RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 13, 1989 **LETTER 1032**

COMING EVENTS: The Soviets badly need food, merchandise, goods. The fact is that aside from arms, the Soviets need everything. The Soviets have printed mountains of rubles. But they're rubles that aren't convertible. Nobody wants rubles. A British banker was asked, "What are rubles worth in pounds?" "Easy," he snapped, "a pound is worth a pound of rubles."

What does the West want? The West wants peace. It wants a reasonable Russia that it can deal with. And it wants expanding markets. Therefore, it wants Gorbachev & Co. to succeed. The West is eager to open up the potentially huge Soviet market. The problem: How do you sell goods to the Soviets? What will they give you for your goods? Worthless rubles? Forget it!

There's a solution, and I think it's going to happen. The Soviets are the world's second largest gold producer. They already have a hoard of 72 million ounces of gold. How do you make the ruble an acceptable (actually, a wanted) currency? Answer: You back it with gold. You make it convertible. You don't trust the new rubles? No problem, turn 'em in for gold. Therefore, I think a gold-backed ruble is in the cards -- it's going to happen -- it's simply a matter of time.

Implications: Within a few years the US could (and I think will) be faced with (1) a united Europe featuring a single strong currency, (2) the Soviets with a gold-backed ruble, and (3) a reasonably strong Japanese yen. This combination would give the world's investors a number of ways of getting out of dollars if they became even more dissatisfied than they are with the way the US is handling its finances.

"Good money drives out bad." What will happen to the dollar in the new order, in the Europe of 1992, in the age of the convertible ruble, in the age of the strong yen? I leave that to your imagination. But do you wonder why gold has risen out of its base to over $400 an ounce?

Meanwhile, the US goes on its way, producing deficits, selling off its assets, and sinking in debt (all the while neglecting long-term investment). Drugs and crime continue to sap US financial and social strength. Congress, seemingly oblivious to the dangers, does little or nothing (aside from masking the deficits).

European and Asian competition continues to grow. The economic disparity between the US and Europe and Japan continues to widen. Europe and Asia are less and less concerned with the need for the US defense umbrella. As we move into the 1990s, the US faces a greater collection of problems than anything it has faced during the 20th century. The problems -- a suspect and weakening dollar, massive debts and expenses, and a Europe and Asia that are turning away from the US. A new kind of economic Cold War could be brewing. It's worth thinking about.

TIDES AND TIDEPOOLS: From a long-term, overall viewpoint, the stock market is always in the grip of a tidal or PRIMARY trend. In other words, the tide is always either coming in (bull market) or going out (bear market).

But if you walk along the beach as I often do, you will notice that there are times when the ocean appears still. Tidepools are everywhere, the waves drift up listlessly on the sand, and you cannot possibly tell whether the tide is coming in or going out -- or indeed whether there is any tide at all.

Dec. 1 DJIA 2752.77; PTI 3297; A-D Ratio -7.22
Dec. 8 DJIA 2731.44; PTI 3299; A-D Ratio -7.31
Dow Yield: 3.90%; Dow P/E: 11.7; DowPow: 652
Dow Book Value: 1075; Dow 200-day MA: 2542
Percentage of Undervalued Blue-chips: 16%

The stock market is not too different. When the Averages are below recent peaks (as they are now) and above recent lows (as they are now), the market is in "no-man's land." Actually, of course, we know that the stock market is always in a bull or bear market phase, but as I said, there are times when the picture seems all fog and confusion. Welcome to the market of December 1989.

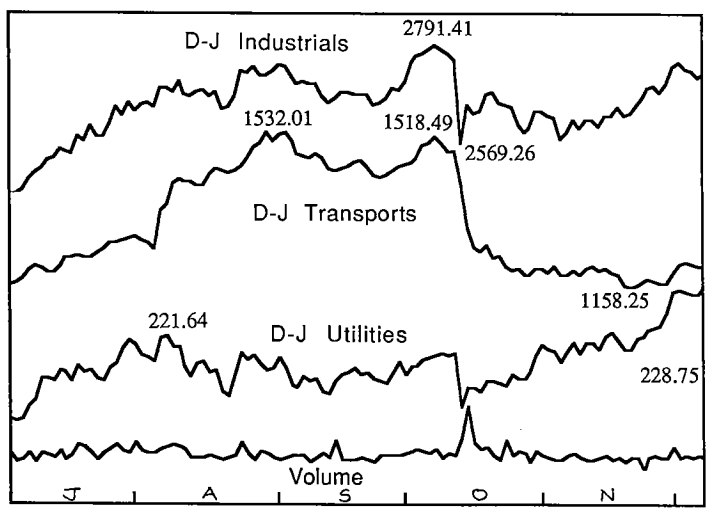
There are a few studies which may help us to understand the situation. Under classic Dow Theory, a stock market movement ENDS at the point where the two Averages (Industrials and Transports) record their last confirmed high or low points. In other words, the movement ends at the point where the Averages record their last highs or lows TOGETHER.

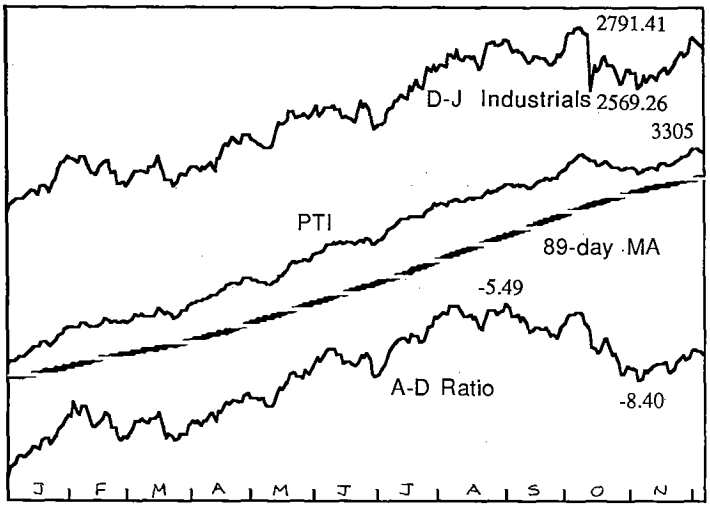
On September 5, 1989, the D-J Transportation Average recorded its all-time high of 1532.01. Although the Industrials continue to push higher and are now actually within striking distance of their all-time high, September 5 is the day on which the last joint highs were recorded. As this is written, the Transports are still roughly 300 points below their September 5 peak. Industrials (although they have rallied) are just below their own all-time high (Oct. 9) of 2791.41.

Therefore, regardless of where the Dow goes from here (even if it goes to a new high), the Transports must confirm -- if the bull market is to continue. In my own personal opinion (and I've said this many times), the Transports are finished. I doubt they are going to climb 300 points from here -- to a new record high.

If the above is true, if the Transports are "out for the duration," then by definition the bull market is over. This is an important thesis, and I hope all my subscribers keep it in mind.

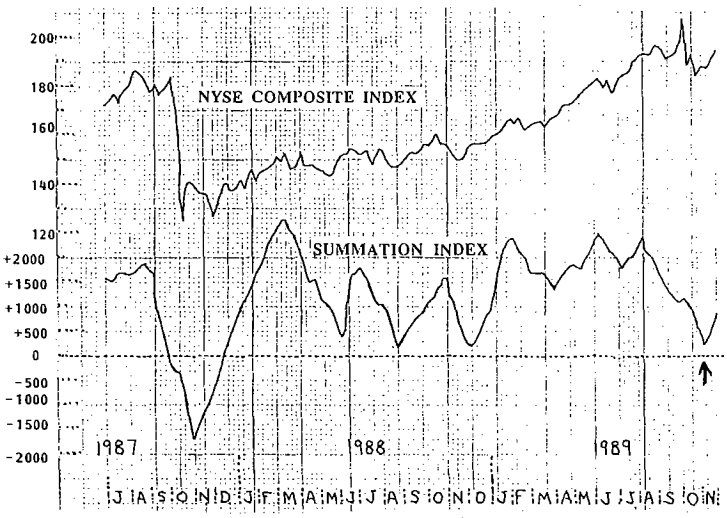
I have commented on and reviewed a number of averages and indices in recent Letters, and I want to review them again now.

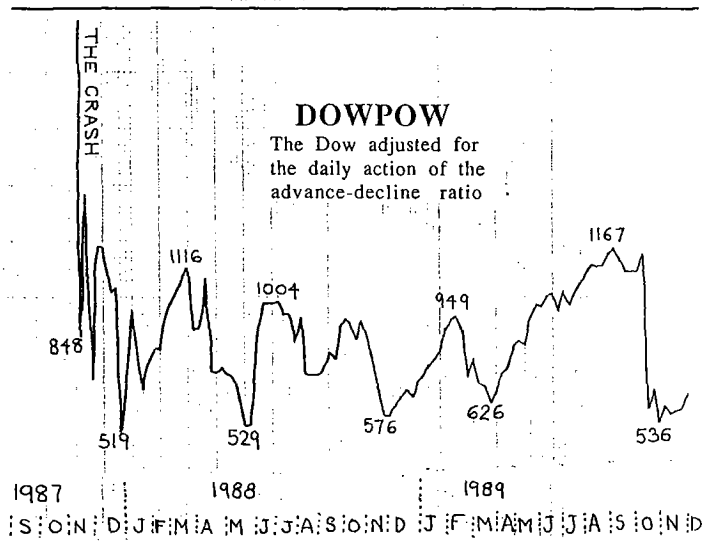




(1) Lowry's Buying Power and Selling Pressure lines (see last Letter) are still in the bearish mode with SP above BP.

(2) The Summation Index (see page 2 chart) declined almost to the critical zero level, then turned up. The latest action tells us that the market is currently in a secondary uptrend.





(3) DowPow, my proprietary index of the Dow adjusted for daily advances and declines, continues to lag badly (see page 2 chart).

(4) The advance-decline ratio (see page 2 chart) has fallen far behind the Dow in the "race" for new highs. This sets up the possibility of a major price/breadth non-confirmation.

(5) Few have noticed, but the NYSE Financial Index (covering ALL financially-related stocks -- S&Ls, banks, small loans, insurance, stock brokers) has sunk to its lowest level since last July.

(6) In his last Letter Joe Granville counted 510 NYSE stocks that were within one point or less of making new lows for the past 52 weeks. This tells us that a slew of Big Board stocks have failed to join the Dow in the latest rise. The above is confirmed when we note that each week roughly 5% of all NYSE issues are sinking to new 52-week lows (check *Barron's* weekly statistics for the weekly new lows). The abnormal abundance of new lows near a Dow high is characteristic of a market top.

There are two very definite pluses in the current picture. (6) My PTI (page 2 chart) has climbed into new high ground. Veteran subscribers have learned not to fight that kind of action -- they respect it.

(7) Last week the D-J Utility Average rose to an all-time high -- above its January 1987 peak of 227.83. Although the Utility Average plays no part in Dow Theory, the Utilities have often, in the past, been leaders.

Overall, however, I continue to keep my eyes on the dramatically lagging Transports and the lagging advance-decline ratio. Throw in the steady stream of daily new lows (running 25 to 50 a day), and I think you've got to be very cautious here.

INVESTMENT POSITION: With my PTI still in a bull trend and with the Summation Index in a bull mode, the picture would appear to be positive. But market action is poor with too many divergences (A-D ratio, Transports, high-lows, etc.). So overall, I rate Wall Street a question mark. And that's what you see in the box.

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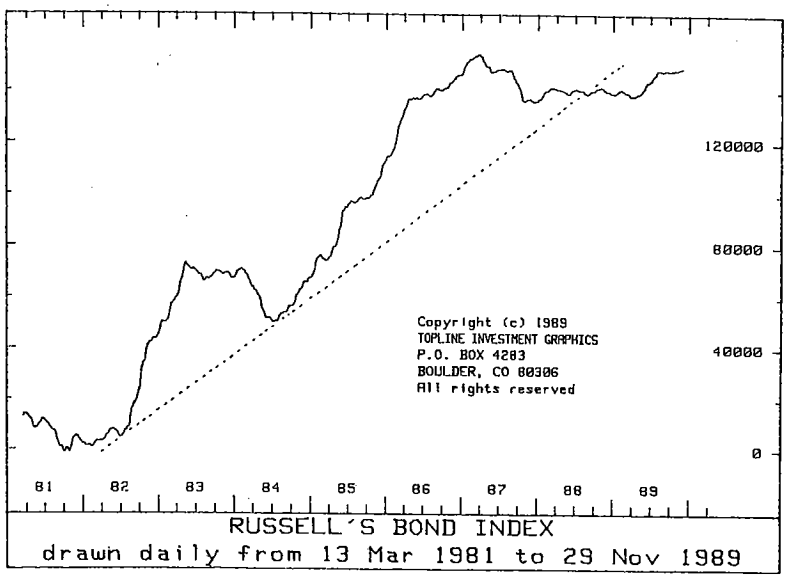
I continue to advise liquidity, and that means money-market funds, T-bills, T-notes of two years or less, and muni cash funds. Shearson has a no-load Global Currencies portfolio, featuring short-term money funds denominated in yen, Deutsche marks, pounds, or Canadian dollars, and if you go that route I suggest marks. Then, of course, there is gold, and I've been recommending gold items all year. Continue to accumulate gold coins on a monthly fixed-dollar amount. If your local dealer isn't competitive, try Benham Precious Metals at 1-800-321-8321 or 1-415-965-8300. Also check with Monex, 1-800-854-3361 or 1-714-752-1400.

The no-load gold funds you can put money in are Lexington Gold Fund (1-800 526 0056), Financial Strategic Gold (1-800 525 8085) and US Gold Shares, which is largely in S. African shares (1-800 873 8637).

BONDS: I've been saying this for a few months, and I want to repeat it. The most widely-held, universal, everybody-is-saying-it opinion on Wall Street and Main Street is that interest rates are definitely heading down and therefore bonds are a great buy.

Maybe so, but when I hear everybody saying the same thing, I find myself growing skeptical. At the same time I watch to see whether the price action jibes with what everybody thinks.

In the case of bonds, the price action has been suspect. The bonds, despite all the bullish predictions and despite a declining Fed Funds rate, have not gone to new highs. What could be happening (or going to happen) to upset the almost unanimous forecast of surging bond prices? Here are three possibilities:



(1) A sharply sliding dollar would send bonds lower. The Japanese took a huge beating during 1978-82 when US interest rates surged and T-bonds went into the tank. They won't take that kind of beating again. If the dollar goes down in earnest, look for Japanese buying of T-bonds to come to a halt -- or (God forbid) we might even look for Japanese selling of T-bonds.

(2) A severe US recession would set off massive federal deficits (via dropping tax receipts). If that happened, you would see the Treasury (in order to finance the deficits) sell bonds in unprecedented amounts. That kind of action would send the bond market reeling.

(3) An unexpected pick-up in US business would cause the Fed to reverse the wheels and tighten credit. Such an unexpected series of events would send bonds lower (although I think this is the least likely of the three possibilities).

Many years ago I developed what I termed the Russell Bond Index. This is based on the action in the NYSE bond market. The Index is computed as follows -- it is simply the differential between the daily advances plus new highs minus the daily declines plus new lows.

My friend, computer expert John Carder, kindly ran this chart off for me. It is a daily chart of the Russell Bond Index going back to 1981. Note the huge rise from mid-1984 through to the first quarter of 1987. From there a decline took the Index to a low in late-1987. During most of 1988 the Index moved sideways. In 1989 the Index rallied again, but the fact is that upside momentum for the Index ended during the first quarter of 1987. Since then the Index has been moving basically sideways.

This Index provides an interesting and unique long-term view of bonds. I think it is telling us that something is wrong in the bond market, despite present enthusiasm.

MEMORIES: I can't help it, I still have trouble getting used to today's prices. For instance, I'll go to a local Chinese restaurant with Faye, my wife, and I'll look at the list of entrees each costing $5.50 to $8. So I'll say, "When I was a kid I'd buy a whole Chinese dinner for 65¢." "Ho hum," Faye answers, "and how much were you making then?" "The ratio is still crazy," I answer as I dig into a wonton.

I was born in 1924, and I grew up in the '30s and '40s -- during the Depression and during World War II. And it isn't my fault that the country has been inflating ever since. At any rate, I want to tell some of my younger readers what it was like "back then" -- when the dollar was "as good as gold," and when Woolworth's was called "the Five and Ten" (that's five cents and ten cents, in case you didn't know), and when a nickel or a dime would buy you a wide range of items.

One of my earliest memories was seeing new Ford sedans (this was about 1935) advertised in the dealer's window for $460. Around that same time I used to go to the Alden Theater (66th and B'way, NYC of course), and it was 15¢ for a double feature movie with a game of Bingo thrown in (one night I actually won $5 at the Bingo drawing, and the thrill lasted a month). Back in the '40s a subway, trolley, or bus ride was a nickel. An ice cream soda was 15¢. The *Sunday Daily News* was a nickel, featuring Dick Tracy comics in color right on the outside page (I couldn't wait to see what that detective with the angular nose would do next). The daily *New York Times* was 3¢, and *Life* magazine was a dime. Then a new magazine, *Fortune*, came out at a dollar, and everyone was amazed -- "A magazine that cost a buck, are you kidding?!"

There was a restaurant on 52nd street called Pick-a-Rib (it was owned by Benny Goodman's brother), and it served marvelous barbequed spare ribs with a big side dish of potato salad for 65¢. I ate there a few times, and my dream was to be able to eat there every night. There was a spaghetti restaurant (who ever heard of pasta) on Broadway called Romeo's. They served a massive plate of spaghetti with meat sauce for a quarter. I loved that place. And those Automats. Sandwiches for 15 to 35¢, coffee or hot cocoa for a nickel, and for 15¢ you got the best individual pot of beans in town.

Back in 1942 at the Paramount (B'way at 44th St.) you could see the big show, like Tommy Dorsey and the latest movie for 75¢ before 12 p.m., but the price jumped to $1.10 after 12. When that stage rose slowly out of the pit with the band playing at full blast -- I mean it was a thrill. Oh yeah, Frank Sinatra was singing with Dorsey; he came with the same 75¢. Sinatra was a big hit back in the early '40s, and the bobby sockers would faint away on cue.

In 1950 I rented a three bedroom apartment in a fine building between Park Avenue and Lexington -- 125 E. 93 Street. My price-fixed rent was $165 a month. I went to a fancy high school in New York called Horace Mann. Tuition was $550 a year, and that was considered kind of expensive. White Castle hamburgers (mmm) were five cents, and a good suit at Saks Fifth cost $65. I could see the latest Broadway show (matinee) for 55¢ although a few theaters charged $1.10. There was a restaurant on 72nd Street just off Broadway called the Cecil. Once a month my father would take the whole family to the Cecil for Sunday dinner and the price was 75¢ for a full course meal (this was around 1938). Then around 1940 they changed the name to Fame Food and the price went to a dollar. My father said the new price was a damn outrage, and we stopped going there.

OK, I know this all sounds kind of nutty. But I've lived through the decline of the dollar, and I've seen the dollar's purchasing power go down the drain. I remember when a guy with a couple of million was considered a rich man. Now a hot baseball player can make that in a year. Today a movie costs $6, and a dinner at a name restaurant can cost (price fixed) $50 to $75. A night at a top New York or LA hotel can run near $400. What, $400 to sleep over, pinch me, I'm dreaming. No, better to humor me, dear readers, humor me, and just tell me that the world has changed. Of course, I know it has, but one thing hasn't changed. It's the steady, relentless erosion in the dollar's purchasing power -- that hasn't changed. And Congress's refusal to balance the budget, that hasn't changed either.

I have only one solution. Vote out incumbent Congressmen. Throw the bums out of office. They've failed in their duty, and they've debased the nation's currency. And that's all I have to say on the subject -- for now.

THANKS: I want to thank the dozens of subscribers who were kind enough to send condolences upon the death of my mother. One subscriber sent a poem which particularly struck me, since I had always wondered where the expression, "The night has a thousand eyes" came from. Subscriber Joseph Chang states that the phrase comes from a poem by Francis William Bourdillon.

The night has a thousand eyes,
And the day but one;
Yet the light of the bright world dies
With the dying sun.

The mind has a thousand eyes
And the heart but one;
Yet the light of a whole life dies
When love is done.

Has this thought ever been expressed better?

NOTES & QUOTES: "Gee, Mr. Greenspan, why haven't you lowered the discount rate?" Answer: High rates are needed to bolster the weak dollar (which seems almost eager to sink to lower levels). But the real reason, according to Elliot Janeway, is that the banks have pressed Greenspan to hold to the higher rates. The banks are currently writing off huge losses, and they need the higher rates. They need the money. Russell comment: Janeway's explanation definitely has the ring of truth about it.

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Who needs Vegas, we've got the S&Ls and the banks! You know about the S&Ls. Here are some leading banks' exposure to what they term "highly leveraged transactions" as a percentage of each bank's equity: Chase Manhattan, 144%; Bank of Amer., 123%; Manufacturers Hanover, 162%; Bankers Trust, 193%; Bank of NY, 192%; Citicorp, 125%; First Chicago, 139%; and Continental, 204%. Do you see why nobody wants to talk about the possibility of a real recession? (Figures are as of June 30, 1989.) Meanwhile, the nation's 12,824 commercial banks reported combined losses of $744 million for the the third quarter -- due to third world loan and US real estate losses.

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Autos: The National Assoc. of Business Economists' 55-member panel has just announced they see no recession for the next three years. Tell it to the US auto industry. Sales are slumping for American companies and plants are being shut down by the the Big Three. Meanwhile, the Japanese-owned "transplant" factories in the US are producing cars for $500 to $800 below costs of the US manufacturers. Chrysler, worst hurt, is selling off its military electronics and Gulfstream divisions in an effort to raise much-needed cash. GM is pinning its hopes on its new Saturn. If it doesn't sell, we're going to see real problems for America's largest manufacturer. Statistic: The Big Three US automakers have seen their share of the US market drop from 84% to 69% in the last decade.

More Autos: The giant 28th annual Tokyo auto show proved one thing -- the Japanese are making major improvements in their products, both technically and in design. Said GM VP William Hoglund, "They really have some very impressive things to show off, particularly in the area of powertrains and suspension." Some of the futuristic Japanese designs left US observers gasping. Said auto analyst Tom O'Grady, "I'd be very concerned if I were a US auto maker coming here. It's almost scary."

Quote of the Month (From Lee Iacocca): "The only reason the Japanese and Italians are the world's greatest builders of small cars is their gas is $4 a gallon. They have to build myriad small cars because that's what their public demands. We build lousy small cars because nobody wants them." Russell comment: Maybe so, but if we built great small cars, I wonder if Americans wouldn't want them. Americans love the new Mazda Miata, don't they?

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Retail: The big retailers are having their troubles as well. L.J. Hooker is putting the Bonwit Teller chain up for sale as well as Sakowitz, the famous Southwest chain. If you want to buy Marshall Fields or Saks Fifth, they're also up for sale. Meanwhile, Campeau is furious at Dunn & Bradstreet. The big credit checker has advised its clients not to ship merchandise to the Campeau stores -- credit reasons, of course.

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The General Accounting Office reported that poor management among federal departments and agencies could cost taxpayers up to $150 billion. The GAO has documented $200 billion in waste and fraud over the past few years, and now they are promising $150 billion more. Comptroller General Charles Bowset said the Defense Dept., IRS, and Medicare are among the 10 worst managed. He added that every major government department has admitted to poor accounting and management systems. Russell comment: Oh, I wondered where my taxes went.

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Government statisticians claim inflation is running at 6% today, but it's going hog wild in baseball (which seems to be following in the footsteps of the NY art auctions). Kirby Puckett signed a three-year contract with Minnesota for $3 million per year. Oakland signed Ricky Henderson at $12 million for four years. Mark Langston signed for five years at a record $16 million. Joan Kroc (owner of the Padres) has put the club up for sale. Said Kroc, "I can't blame the players or their agents. It's human nature to go for what the market will bear. But what in the heck is wrong with the ownership? They shoot themselves in the foot every time. I'm so disappointed, and to tell you the truth, I'm glad I'm going to be out of it." Two weeks ago Joan gave $1 million for a scholarship to send San Diego high school students to area colleges. Obviously, Kroc feels better spending her money that way. Can anyone blame her? (Note: With last week's fight, Sugar Ray Leonard's total boxing earnings on 38 fights went over $100 million.)

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The Russell Ability Formula states that in any given profession 5% of the participants will be brilliant, 10% will be smart enough to follow the 5%, and the rest (85%) will vary from good to fair down to incompetent. Along this vein, the number of serious disciplinary actions against doctors rose in 1989 for the fourth year in a row (up 17% this year). In 1989 there were 1,495 cases of license revocations, suspensions, and probations.

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Past experience tells us that when anything is trendy enough to make the cover of *Time* magazine, that trend is usually over. Thus, the *Time* cover has become a great contrary opinion vehicle. *Time*'s Nov. 27 cover headlines, "Art and Money, Who's Winning and Who's Losing as Prices Go Through the Roof." Has the Nov. 27 *Time* cover spelled "top" for the great art mania of the '80s? Let's watch it and find out.

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According to *Women's Wear Daily* (yeah, I told you I read everything), "Wall Street analysts and other financial experts were less than impressed with operating results and the presentation in the confidential offering for Bloomingdale's prepared by First Boston Company. As one investment banker put it, 'The book is all puff and no substance. . . .There are no profit figures on the branches. There are not nearly enough facts and figures to use in preparing a bid.' " Another noted that "Bloomingdale's is essentially a 59th St. business. . . It's not as big a business as I imagined it to be." In the meantime, Bloomies is being offered to the world at a price of $1 billion or more (that's the minimum bid that will be accepted).

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On December 31, 1992, the new Europe will come into being. At that time barriers to internal trade will be removed, and products will have to conform to common standards. Competition promises to be brutal, and weak or ill-prepared companies will go under.

On top of that, something new has been added. Cheap labor via East Germany and the former Soviet satellites. To my mind, it is a given that East Germany will be at least economically united with West Germany. Don't ever underestimate the German ability and willingness to work. Today, West Germany, with half of Japan's population, is the world's largest exporter of goods. With the economic link-up to East Germany in the cards -- watch out. You're looking at a future economic colossus.

The new Europe of 1992 is planning for a single stock market, the Federation of Stock Exchanges. At a recent meeting in London, members agreed to create a European-wide information system available on computer screens to all European brokers. My guess is that at that time all Europe will also be trading major US stocks.

Gorbachev may not survive and hard liners may again take over Russia. The reason: the Russian economic collapse. The fact is that Russian citizens are worse off today than they were five years ago

when Gorby first took power. Predicts a top NATO European official, "Unless Gorbachev arrests the economic decline he won't be there in two years. Even stagnation might be enough to save him. But right now things are going down hill fast."

Cynical Russell view of what may be happening: Gorbachev sees the Soviet empire sinking, going bankrupt under a prehistoric, unworkable economic plan. Russia must get out from under. Gorbachev scenario: Call for disarmament, shake hands with the US. Then loosen the hold on Soviet satellites, dump the satellites on the West, let the West bail the satellites out. Meanwhile, the Soviet Union works closely with a very willing Germany. Germany builds factories in the Soviet Union on a partnership basis (using cheap Soviet labor), while opening up the potentially huge Soviet market to German business. The problem: the Soviet Union wants to be part of Europe-1992, but the Soviets are only making half-changes in their economy. That won't work. Capitalism can't operate without a free market, something the Soviets refuse to deal with.

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England's Rolls-Royce has come out with its new line. As usual, it was a bit pricey. The 1990 Bentley will be $114,100, up from last year's $108,700. The Turbo R is $167,000, up from $149,500. And the convertible is $215,000, up from $204,800.

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There is one area in which the US absolutely excels, and that is entertainment. The Japanese want to be a factor in the field, but they just don't have the talent. So they're buying the talent. When Sony bought Columbia Pictures, they wanted two top executives, both of whom worked for Warner's. Sony paid $200 million to get the Guber-Peters Entertainment Co. (Guber and Peters, who produced "Batman," come with the deal.) Of that $200 million, the two execs will get $55 million each. In addition, they will receive a base salary of $2.75 million a year for five years with cost-of-living adjustments. They will also get profit-sharing plus installments on a one-time $50 million bonus. And they will share 8.08% of any appreciation in Columbia's assessed value. On top of all that, Sony also paid Warners $500 million to buy Guber and Peters out of their contract. Shows what you can do if you want something bad enough, and you have the cold, hard cash to back it up.

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In the old days, black Africa's population increased 2 1/2% annually. But 30 years ago the rate jumped to a 3 1/4% rate, the highest rate ever recorded for a continent. Since 1965, Africa's population has doubled, and if the current rate holds, Africa's population will double again (to 1 billion) in 20 years. But there's a catch -- AIDS. The disease is raging across Africa at a rate so high that statisticians claim that Africa's population growth could possibly drop to zero. So far, 300,000 Africans have died from AIDS, and it is estimated that 2.5 million are now infected. A recent survey shows that 6.4% of African city populations are infected with the AIDS virus.

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Help! My quiet little city of San Diego has just passed Detroit to become the sixth largest city in the US. San Diego's population (300,000 when I first moved here) is now 1.07 million and rising by the day. What may stop the influx is the high price of housing. The affordability rate in SD is a minuscule 14%, meaning that only 14% of the people here can afford a median-priced house with their level of income. But it's the great weather and outdoor life that keeps 'em coming.

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You hate rain? You love dry? San Diego's got it. If it doesn't rain between now and the end of December (and the skies never looked sunnier here), San Diego will have received a TOTAL of 2.82 inches of rain in 1989, making it the driest San Diego year since meteorologists started keeping records in 1850.

But before you pack up and move to San Diego, ponder this: about 25% of all US defense spending goes to California, and defense spending is going to head down -- and down. Defense cutbacks will hit California hard, and the down-trend will be a long one. The defense stocks are already telling the story.

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Seymour Durst knows about the US debt. And he wants everybody else to know about it too. So on the side of the Durst Organization building (one block east of Times Square in NYC) Durst has a 25-foot wide digital sign which posts the rate of increase in the federal debt ($8,000 a second), how much interest is accruing, and the amount of the total debt each citizen owes (latest, $44,195 per family). Durst wants to erect a national debt clock in Washington, D.C. -- to give Congress something to look at. "I know a couple of Congressmen," says Durst, "and they don't like me very much."

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The trend in Beverly Hills is to enormous new homes, many in the 30 to 40 thousand square foot range. Older homes are being torn down en masse. One real estate expert states, "I said five years ago that every house in Beverly Hills or Bel-Air is a candidate for a tear-down, with very few exceptions." Why? What's happening? Says another expert, "The powerful people usually want to build a monument for themselves. What can they do? They can wear the best clothes, they can drive beautiful cars, they can eat the best food. But when they get older they can't eat the best food, and they can't drive so they get a car and driver. What's left for them but to build a monument-style home."

* *

Merrill Lynch has the gall to decide that it will no longer handle any S. African stocks for its customers. Merrill has decided to make "ethical" decisions for its customers. Will Merrill cease trading tobacco stocks? What about Exxon, which polluted the Alaskan waters and then tried to avoid the full clean-up? Is Merrill banning the gambling stocks such as Resorts or Bally? Ironically, S. Africa has moved steadily toward eliminating apartheid. Thanks Merrill -- for your belated cowardice.

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The top US cities rated on their ability to attract executives from outside the area: (1) Atlanta; (2) San Diego; (3) San Francisco; (4) Seattle; (5)Boston; (6) Phoenix; (7) Chicago; (8) Denver; (9) Dallas-Ft. Worth; and (10) Tampa.

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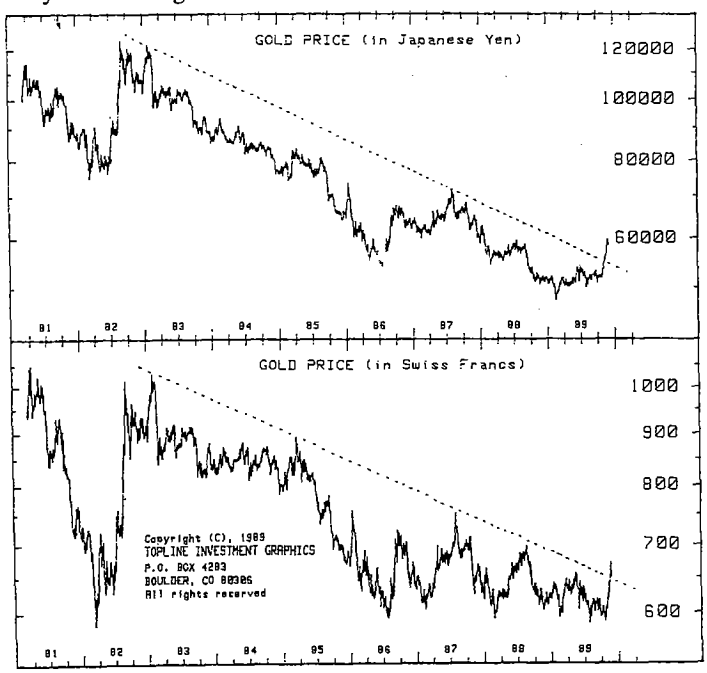
Noo Yawk: Starting salaries in the top 10 New York law firms -- $83,000. Not bad for beginners, but then it isn't easy to get into one of the top 10 firms. . . . Gov. Cuomo's office is talking about a possible $2 billion deficit for the state -- problem, tax take is dropping and expenses too high. Don't blame the shortfall on parking meters. In NYC parking meters take in $50 million a year and parking fines in the City are $220 million. That's better than a quarter billion a year for parking! Meanwhile, many New Yorkers are fighting Donald Trump's new dream city, to be built on 76 acres of rail yard land bordering the Hudson River. "We're Trumped out," say the objectors. But Trump City is planning for 11 apartment towers up to 60 stories high, 1.5 million square feet of retail space, total floor space for apartments of 14.5 million square feet, and the world's tallest tower building -- 150 stories.

TECHNICAL POINTS: The CRB Commodity Futures Index has broken down to the 225 area. No inflation there. In the grains, wheat looks strongest. A price of 4.15 on the March wheat contract would confirm a bull trend. Copper, an industrial barometer, has broken down badly. Upside reversal would come at 1.095 on the March contract. Crude oil is moving sideways -- a price of 18.70 on the March contract would be bearish. The Japanese yen is ready to break out against the dollar, and the Swiss franc is bullish against the dollar, as is the German mark and the Canadian dollar. The British pound is the weak currency, but lately has been moving sideways against the dollar. Watch the March T-bond contract carefully -- a rally to 101 1/2 would be bullish while a drop to 98 1/2 would be a very bearish signal.

The Dow stocks are very mixed -- strong stocks include AT&T, Chevron, Coca-Cola, GE, McDonalds, Merck, Proctor, Texaco, Westinghouse. Philip Morris is strong but weakening. Weak stocks are Allied Signal, Aluminum Ltd., GM, Union Carbide. Outstandingly weak stocks are Beth. Steel, Goodyear, IBM, Kodak, Navistar, Sears. The market is remarkable in that it has rallied with two bellwethers very weak -- GM and IBM. Ten years ago nobody would have believed a rally possible without these two stalwarts.

GOLD: Over the past month (after the gold breakout above 400) gold and the precious metals were swept by a bit too much bullishness, too much enthusiasm. Having rallied almost to the 420 area, gold backed off and cooled off. And that's OK -- that's good action.

Foreigners haven't been interested in gold for years -- UP TO NOW. The accompanying charts (again by John Carder) prove it. Note that the price of gold in both Swiss francs and Japanese yen has been declining on a trend basis ever since 1983. Gold in francs hit a low in 1986, fluctuated sideways for two years, BUT just recently rallied to reverse that six-year declining trendline. Gold in yen declined year after year, hitting a low in the first quarter of 1989. A few weeks ago gold in yen reversed and broke out above a six-year declining trendline.



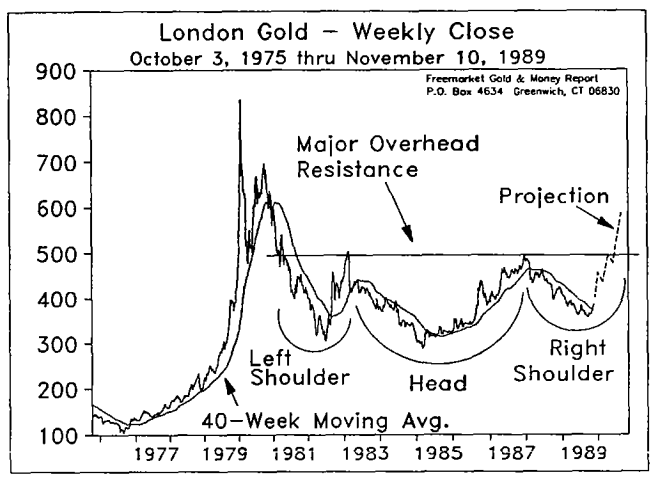
Is something new happening? There's no question about it, nations are starting to step up their central bank positions in gold. But the big picture is one of nations and individuals hedging against the world's reserve currency, dollars. If the Soviets back the ruble with gold, that will put pressure on the dollar to do the same. The mark and the yen don't need gold backing. The strong, conservative economies of those two nations are sufficient backing for their currencies. And by the way, the latest issue of the London *Economist* notes, "Gold fever is sweeping the Soviet Union. With huge ruble deposits that can buy nothing useful in the shops, savers are turning to gold and other valuables as the only means of defending their savings against destruction by price reform."

A deteriorating US economy in the face of strong foreign currencies will put major pressure on the dollar. And ultimately (particularly in view of the US's 260 million ounce hoard of gold) the US could be forced to move to a gold-backed dollar. Or barring a gold-backed dollar, the US could be moving close to the time when it will have to issue gold-backed government bonds in order to sell the huge quantities of bonds that will be needed to finance the US's ever-compounding deficits.

In its most recent report, *Growth Fund Guide* (Box 6600, Rapid City, SD 57709) makes some extraordinary observations: "Given current trends, the US will have more external debt in about two years than all of the rest of the world put together. And the more you look out into the future, the bleaker the picture becomes. The present US debt is close to $3 trillion. If we assume that the budget, less interest owed on the national debt, will be balanced every year, and that money can be borrowed for a reasonable overall cost of say 8% a year, then the US would be about $8 trillion in debt by 2001. If we add $100 billion per year deficit on top of the interest owed, then the US would owe $10 trillion by the year 2001, and almost $20 trillion by the year 2010. This type of compounding can not and will not take place unless the US is destined to become a super-inflationary South American style disaster. Our government will have to end its addiction to spending money it does not have. Ending this addiction will, of course, cause problems, and the longer the addiction lasts, the larger the problems will become."

So the specter is really one of hyper-inflation or, to put it kindly, a severe recession. One way leads to a collapse in the dollar (or an explosion in the dollar cost of gold); the other way leads to a crisis in the financial system.

All of the above has gone to build the huge 1981-89 base in gold. It's a base that can be seen in this chart (courtesy of *Gold & Money*, PO Box 4634, Greenwich, CT 06830). As you can see, the action of gold since the 1982 low has taken the form of a massive head-and-shoulders base. The move above 400 was just the initial step, the catapult out of the base. The real resistance comes in at the 500 level. Technically, that's the problem gold faces now. If gold works its way up to 500, it will have moved up to a critical level. Get gold above 500 and the technical situation would allow for a further rise to the 750 area. But let's not get ahead of ourselves. The problem, the task for gold now, is to work up through the 400 zone to the 500 level.



As I see it, the next target for gold on the upside is to get above the 428 level. From there gold would have to push above 452. Why 452? That's where an important point & figure (declining) trendline comes in. Gold above 452 would be in position to attack the all-important 500 level.

LATE NOTES: I was talking last week with an old friend of mine, a partner in a New York brokerage firm. My friend asked me for the latest reading on the PTI, and then said, "You know, your PTI is developing quite a following among the traders and even among institutional managers here in the City." I answered that I didn't know whether that was good or bad, but I guessed it was all right, because the PTI is based on eight market indices that simply cannot be manipulated (all eight indices deal with the action of the market).

I know there are many people who subscribe to Dow Theory Letters strictly so that they can follow the trend of the PTI. Basically, the PTI is all they're interested in. They couldn't care less about my opinions on the market or anything else. And that's fine with me, because I never tell anyone how to read these Letters or what to get out of them. Some subscribers read the Letters for the gold section alone; others read them for the stock market comments or for my philosophy. And many people tell me (believe it or not) that they subscribe because they or their wife or kids like the Notes & Quotes section. As I said, I'm not insulted, and it's OK with me. I enjoy writing these Letters, and if you get something out of just one section or all the sections -- I'm pleased. In the meantime, note that the PTI (now near its high) gives ground very reluctantly.

NEXT MAILING: Dec. 27